

May 01, 2008

GLORIA L. FRANKLIN, CLERK

U.S. BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

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CLERK
United States Bankruptcy Court
San Jose, California

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN JOSE DIVISION**

In re

Case No. 02-55795-RLE

3DFX INTERACTIVE, INC.,

Chapter 11

Debtor.

Adv. Proc. No. 03-5079

WILLIAM A. BRANDT, JR., TRUSTEE,

Plaintiff,

vs.

nVIDIA CORPORATION, a Delaware
Corporation; et al.,

Defendant(s).

MEMORANDUM DECISION AFTER TRIAL

Before the Court is the First Amended Complaint (the
"Complaint") filed by William A. Brandt, Jr., the Trustee of

[3dfx.nvidia.decis.4.08.]

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1 the above-captioned chapter 11 estate of 3dfx Interactive,
2 Inc. (the "Trustee" and "3dfx"), against nVidia Corporation
3 and nVidia U.S. Investment Company (collectively, "nVidia")
4 for avoidance of a fraudulent conveyance. This phase of the
5 case has been tried and submitted for decision.

6 The Trustee is represented by Peter G. Bertrand, Richard
7 C. Darwin and Kim Y. Arnone of Buchalter Nemer. nVidia is
8 represented by Robert P. Varian, Karen Johnson-McKewan and
9 James N. Kramer of Orrick, Herrington & Sutcliffe LLP.

10 This Memorandum Decision constitutes the Court's findings
11 of fact and conclusions of law pursuant to Federal Rule of
12 Bankruptcy Procedure 7052.

13 I. FACTS

14 A. Procedural Background

15 1. The Adversary Proceeding

16 3dfx filed this chapter 11 case on October 15, 2002, and
17 the Trustee was appointed January 24, 2003. On February 24,
18 2003, the Trustee commenced this adversary proceeding.

19 The Complaint states four claims for relief based on
20 California Civil Code §§ 3439.04(a) and (b) and § 3439.05
21 (California's Uniform Fraudulent Transfer Act (the "UFTA")),
22 applicable here through Bankruptcy Code § 544(b)(1). The
23 Trustee alleges that in the transaction between nVidia and
24 3dfx (the "Transaction") documented in the Asset Purchase
25 Agreement dated December 15, 2000 (the "APA"), nVidia paid
26 less than reasonably equivalent value for what it received.
27 nVidia responded to the Complaint and the parties have engaged
28 in extensive discovery.

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1 In August 2005, the Trustee filed a motion for summary
2 judgment which nVidia opposed. On December 22, 2005, the
3 Court issued an order granting in part and denying in part the
4 Trustee's motion (the "Summary Judgment Order"). Docket no.
5 172. The Summary Judgment Order provides that judicial
6 estoppel precludes nVidia from asserting in this action that
7 the "transaction value" is anything other than \$108 million.
8 The Court denied summary judgment regarding what specific
9 assets were transferred in the Transaction and the value, if
10 any, to be ascribed to them.

11 **2. The Questions to be Tried**

12 On January 26, 2007, the parties filed a Joint Statement
13 of Legal and Factual Questions for Trial (the "Joint
14 Statement"). Docket no. 237. On January 31, 2007, the Court
15 issued a Pre-Trial Order establishing a schedule for trial and
16 the manner in which this valuation phase of the trial would be
17 handled. Docket no. 253. A timed trial took place between
18 March 21, 2007 and April 5, 2007. Post-trial briefing is
19 complete and the matter is ready for decision.

20 Pursuant to the Joint Statement and Pre-Trial Order, the
21 issues to be determined at this phase of the case are:

22 In the Transaction:

23 1. What was transferred and/or surrendered by 3dfx to
24 nVidia?

25 2. With respect to what was transferred and/or
26 surrendered, what is subject to avoidance under applicable
27 state and federal fraudulent transfer statutes?

28 3. With respect to what is identified in the answer to

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1 the second question, what was the fair market value as of the
2 date it was transferred and/or surrendered?

3 4. Was the \$70 million paid by nVidia reasonably
4 equivalent to the fair market value identified in the answer
5 to the third question?

6 **3. The Witnesses**

7 nVidia offered direct testimony by declarations from the
8 following witnesses which were admitted into evidence:

9 1. Jen-Hsun Huang, president and chief executive officer
10 of nVidia.

11 2. Christine Hoberg, former chief financial officer of
12 nVidia.

13 3. Alex Leupp, former president and chief executive
14 officer of 3dfx.

15 4. Phil Carmack, senior vice president of the handheld
16 GPU business unit of nVidia, former vice president of hardware
17 engineering at 3dfx and former executive vice president of
18 research and development at 3dfx.

19 5. Paul D. Carmichael, former in-house counsel for
20 nVidia.

21 6. Mark Maxson, a principal in the valuation practice at
22 Deloitte & Touche.

23 7. Mark Waissar, former vice president at Morgan
24 Stanley.

25 nVidia offered direct testimony by declarations and
26 reports from the following expert witnesses which were
27 admitted into evidence:

28 1. Roger J. Grabowski, regarding valuation issues.

- 1 2. Roman Weil, regarding accounting issues.
- 2 3. Jon G. Peddie, regarding graphics industry issues.
- 3 4. Charles D. Murphy, III, regarding investment banking
- 4 issues.
- 5 5. Matthew R. Lynde, regarding patent damages issues.

6 The Trustee offered direct testimony by declarations and
7 reports from the following expert witnesses which were
8 admitted into evidence:

- 9 1. Richard Ferraro, regarding industry issues.
- 10 2. Michael J. Wagner, regarding valuation issues.

11 The Trustee also offered testimony by designated
12 deposition excerpts for Paul Carmichael, Richard Hedderson,
13 Steve Pettigrew as part of his case-in-chief.

14 The Court heard testimony from nVidia's experts Messrs
15 Weil, Peddie, and Murphy and from the Trustee's experts Messrs
16 Ferraro and Wagner.

17 The Court also heard testimony from Jen-Hsun Huang,
18 Christine Hoberg, Alex Leupp, Mark Maxson, and Richard Cording
19 (the former controller of nVidia).

20 Designated deposition excerpts were also admitted into
21 evidence. Before trial, both parties filed evidentiary
22 objections to certain parts of the declarations and experts'
23 reports. The Court ruled on these objections, in part, before
24 trial began.¹ To the extent the Court relies upon any
25 evidence for which there may have been a pending objection,
26 any such objection is overruled.

27
28 ¹ See generally Docket nos. 311-344, 366, 372, 382.

1 **B. Background Regarding the Parties**

2 **1. The Brief Life of 3dfx**

3 3dfx was a publicly traded semiconductor company
4 incorporated in California in 1994. Its initial public
5 offering took place in April 1997. 3dfx described itself as
6 part of the world of "interactive electronic entertainment"
7 that had started with coin-operated arcade games, then moved
8 into home entertainment through the advent of inexpensive,
9 dedicated home game consoles that attached to televisions and
10 then progressed to games playable on personal computers. Ex.
11 5011, pp. 4-5.² 3dfx claimed that its products were used in
12 more than 700 titles for personal computer games and more than
13 20 titles for arcade games. Game titles included *Everquest*,
14 *Alien vs. Predator*, *Hydro Thunder*, and *Savage Quest*. Ex.
15 5011, p. 10.³

16 3dfx first shipped its graphics products (known as the
17 Voodoo Graphics chipset) in September 1996 and introduced
18 subsequent versions in 1997, 1998 and 1999 (with variations on
19 the Voodoo name, such as the Voodoo 2, 3, 4, and 5, Voodoo
20 Rush and Voodoo Banshee). 3dfx's target market had
21 historically been the retail market for add-in graphics cards
22 and 3dfx had devoted significant energy to establishing 3dfx
23

24 ²Well-known manufacturers of these game consoles include
25 Sony Corporation, Nintendo Corporation, and Sega Enterprises,
26 Ltd. Successive generations of these game consoles have been
introduced for many years.

27 ³References to the reporter's transcript of trial
28 proceedings will be as follows: "RT ____." References to
Exhibits will be as follows: "Ex. ____."

1 and Voodoo as brand names in the retail market. Ex. 5011, pp.
2 6-8. At the time of the Transaction, Voodoo Rampage was in
3 development but had not been completed. Voodoo Rampage had
4 been "taped out" in early December 2000 but it could have been
5 as much as another year before it would have been ready for
6 commercial exploitation. RT 1503-1505 and 1319-1321.

7 **2. 3dfx Merger with STB Systems, Inc.**

8 Before May 1999, 3dfx was what is known as a "merchant
9 chip" business - it designed and sold graphics chips to a
10 variety of companies who then used the chips in their own
11 products. In May 1999, 3dfx completed its acquisition of STB
12 Systems, Inc. ("STB"), a Texas based graphics board company
13 with a manufacturing facility in Mexico. Ex. 5011, pp. 3, 14.
14 The purpose of the 3dfx/STB merger was to allow 3dfx an avenue
15 to deliver the 3dfx graphics chip directly to the
16 retail/distributor market on a graphics board designed and
17 built by 3dfx rather than on graphics cards designed by
18 various third party companies. Ex. 5011, p. 3. The
19 acquisition of STB fundamentally changed 3dfx's business
20 strategy. Alex Leupp, former chief executive officer of 3dfx,
21 characterized the STB acquisition as a "mistake." Ex. BV, ¶6.

22 Jon Peddie,⁴ nVidia's industry expert, also described the
23 STB merger as an ill-advised strategic decision:

24 //

25 _____
26 ⁴ See Ex. BZ, ¶¶3-9 for details regarding Mr. Peddie's
27 credentials. Mr. Peddie is the principal of a technically
28 oriented marketing and management consulting firm that issues
market reports and publishes a bi-weekly report on computer
graphics and emerging trends in digital media technology.

1 This change in 3dfx's business and product offerings
2 brought it into direct competition with companies that
3 had previously been major customers. Although this
4 decision was intended to simplify the design process and
5 shorten product cycles by putting its chips in a single
6 board design . . . 3dfx's transition from a merchant chip
7 company to an add-in board company undermined 3dfx's
8 customer relationships and reduced its sales.

9 Ex. BZ, ¶15.

10 Following the merger, certain operating functions of each
11 company were combined in an attempt to achieve operating
12 efficiency. Various engineering functions were merged to
13 coordinate the graphics chip design process and graphics board
14 design process. The sales and marketing operations were
15 unified to address customer needs, particularly in the
16 retail/distribution channel. Ex. 5011, p. 3. However, as a
17 result of the merger, 3dfx lost two customers who had
18 accounted for 58% of its total revenues for fiscal year 1998.
19 3dfx was unable to replace the lost revenues attributable to
20 these two significant customers. STB revenues also declined
21 after the merger because STB was unable to sell boards
22 incorporating graphics chips from other companies. Ex. 5011,
23 p. 21; Ex. BV, ¶¶5-6.

24 **3. 3dfx Merger with Gigapixel Corporation**

25 In July 2000, 3dfx completed a merger with Gigapixel
26 Corporation ("Gigapixel"). One apparent rationale for this
27 merger was to expand the number of engineers working for 3dfx.
28 Gigapixel had about 40 graphics engineers at the time of the
merger who became 3dfx employees. Ex. BV, ¶7. Mr. Leupp
testified that the main purpose of 3dfx acquiring Gigapixel
was Gigapixel's relationship with Microsoft and the X-Box

1 (then in development), and Gigapixel's innovative approach to
2 designing graphics chips. RT 1291. Mr. Peddie described the
3 Gigapixel merger as a "desperate move" which was difficult to
4 link with a rational business purpose. Ex. BZ, ¶15.

5 **4. Relationship between nVidia and 3dfx**

6 Historically, nVidia and 3dfx had developed a well-known
7 rivalry with each other in the small field they occupied. As
8 Mr. Leupp, described it, "[b]efore 3dfx bought STB Systems,
9 3dfx and nVidia had been serious competitors with one another.
10 The two companies were rivals down to the bone, and I
11 understood that the culture among our engineers was hostile to
12 nVidia." Ex. BV, ¶27.

13 By the fall of 2000, nVidia did not view 3dfx as a direct
14 competitor because following the STB merger, 3dfx sold only
15 its own boards incorporating its own graphics chips. Ex. BT,
16 ¶11. Jen-Hsun Huang, nVidia's chief executive officer,
17 testified that nVidia's market focus was on selling its chips
18 to original equipment manufacturers, whereas 3dfx's focus was
19 primarily on selling its chips as part of add-in boards sold
20 directly in the retail channel. At the time, the end-users of
21 nVidia's chips were purchasers of computers that already
22 contained an nVidia graphics chip. Thus, the end-users of
23 3dfx's chips were people who purchased an entire graphics
24 board containing 3dfx chips from retailers and then added
25 those boards to their computers. Ex. BT, ¶5; Ex. 5011, p. 15.

26 3dfx and nVidia were also suing each other for patent
27 infringement (collectively, the "Patent Litigation"). In
28 September 2000, the District Court hearing the Patent

1 Litigation issued a ruling favorable to 3dfx, largely adopting
2 the 3dfx position and largely rejecting nVidia's. Ex. 53; RT
3 187.

4 **5. 3dfx's Financial Problems**

5 In the beginning of 2000, 3dfx had approximately 650
6 employees. Approximately 265 of these employees were
7 engineers. 3dfx's Mexican subsidiary also had roughly 1200
8 employees working in its Juarez, Mexico board manufacturing
9 facility. 3dfx had business premises in San Jose, California
10 and Richardson, Texas. Its graphics chips were manufactured
11 in Taiwan. Ex. 5011, p. 16.

12 Mr. Peddie testified that although 3dfx was not a small
13 company, its competitors, including nVidia, were larger and
14 more sophisticated and also had stronger financial backing.
15 Because of 3dfx's limitations, it fell behind the technology
16 cycle, produced inferior products, and its operation as a
17 merchant chip company was doomed. By the fall of 2000, 3dfx
18 had effectively designed itself into a corner by committing to
19 an outmoded chip architecture that was not scalable or
20 economical. The company did not recognize the importance of
21 single chip compatibility, and ignored the importance of
22 industry compatibility. Ex. BZ, ¶¶12-13.

23 3dfx's SEC filings confirm this general assessment as did
24 Mr. Leupp. Ex. BV, ¶¶8-9; Ex. 5011, p. 35; Ex. 5054, pp. 19-
25 23.

26 By the time of the Transaction on December 15, 2000, 3dfx
27 had sustained losses each quarter since the quarter ending
28

1 April 30, 1999.⁵ By the end of the third quarter of 2000,
2 3dfx was also experiencing high inventory expenses, declining
3 margins and slowing demand for its products. Ex. BV, ¶8; Ex.
4 BU, ¶8.

5 In its 10-Q filed on December 20, 2000, 3dfx reported a
6 net loss of \$291.5 million for the nine months ending October
7 31, 2000, and reported that during the three months ending
8 October 31, 2000, it had recorded a charge of \$117 million for
9 the impairment of goodwill and other intangibles. Ex. 5054,
10 pp. 3, 9-10.

11 By the fall of 2000, not only had 3dfx suffered six
12 consecutive quarterly losses, but it also had essentially run
13 out of cash, and had even invited bankruptcy counsel to
14 address the November 20, 2000 board meeting. Ex. 5027.
15 According to Mr. Leupp, whether or not 3dfx signed a deal with
16 nVidia on December 15, 2000, 3dfx would have found it
17 necessary to lay off most, if not all, of its employees. Ex.
18 BV, ¶36.

19 **C. Events Preceding the Transaction**

20 **1. 3dfx Retains Robertson Stephens**

21 _____
22 ⁵3dfx had reported a net loss of \$2.1 million for the
23 quarter ending April 30, 1999; a net loss of \$11.6 million for
24 the quarter ending July 31, 1999; a net loss of \$17.6 million
25 for the quarter ending October 31, 1999; a net loss of \$31.9
26 million for the quarter ending January 31, 2000. Ex. 5011, p.
27 27. 3dfx reported a net loss of \$12 million for the quarter
28 ending April 30, 2000, a net loss of \$100 million for the
quarter ending July 31, 2000. Ex. 5015, p. 2. 3dfx reported
a net loss of \$178 million for the 3 months ending October 31,
2000. Ex. 5054, p. 2. 3dfx reported a net loss of \$63
million for fiscal year 2000. Ex. 5065, p. 3.

1 In September 2000, 3dfx decided to try to sell its board
2 business assets and retained Houlihan Lokey Howard & Zukin to
3 advise it in that effort. In October 2000, 3dfx also retained
4 the investment banking firm of Robertson Stephens to conduct a
5 search to identify parties interested in either a strategic or
6 financial transaction with 3dfx. Robertson Stephens was well
7 recognized at the time as one of the premier investment
8 banking firms for technology companies such as 3dfx.⁶ 3dfx
9 management and Robertson Stephens gave information to numerous
10 parties, several of whom signed confidentiality agreements and
11 received detailed information regarding 3dfx. Ex. 5057, pp.
12 42-43.

13 3dfx also explored several restructuring alternatives,
14 including selling the board business assets and returning to
15 its previous model of designing and selling graphics chips,
16 selling the board manufacturing assets in Mexico, and selling
17 the stock of STB. 3dfx approached several companies,
18 including Intel, ATI, and AMD, regarding potential
19 transactions. None of these companies were interested. Ex.
20 BV, ¶¶11-18.

21 **2. nVidia Retains Morgan Stanley**

22 Following contact initiated by 3dfx in September 2000,
23 nVidia indicated its interest in exploratory discussions. Ex.
24 BT, ¶9. Around this same time, nVidia retained Morgan Stanley
25

26
27 ⁶Mr. Peddie described Robertson Stephens at the time as
28 "widely recognized as one of the premier - and perhaps the
premier - investment bank/financial advisor for West Coast
technology firms such as 3dfx." Ex. BZ, ¶18.

1 to assist it in the evaluation of a potential transaction with
2 3dfx. Ex. CE, ¶¶13-17. On or about November 20, 2000, nVidia
3 and 3dfx entered into a letter agreement relating to the
4 treatment of confidential information (the "Non-Disclosure
5 Agreement"). Ex. 5026.

6 In late November 2000, Morgan Stanley provided the nVidia
7 board of directors with its analysis of a potential
8 transaction between 3dfx and nVidia (the "Project Titan
9 Materials"). Ex. 5028.⁷ Mark Waissar, who led the Morgan
10 Stanley team working on the assignment, described this
11 presentation to the nVidia board as reflecting a preliminary
12 analysis period during which Morgan Stanley evaluated 3dfx's
13 entire business because Robertson Stephens had requested that
14 nVidia evaluate a purchase of the entire company, and
15 Robertson Stephens did not believe that a partial purchase of
16 assets would be feasible. Accordingly, the presentation
17 primarily contemplated a merger structure between nVidia and
18 3dfx. Ex. CB, ¶¶12-13.

19 In the Project Titan Materials, Morgan Stanley expressed
20 its preliminary view that 3dfx's liabilities exceeded its
21 assets and that 3dfx had little or no enterprise value.
22 However, the presentation also stated that other off-balance
23 sheet assets including 3dfx's engineering workforce had

24
25 ⁷Ex. 5028 was filed under seal pursuant to a protective
26 order and remains sealed; it was admitted for the limited
27 purpose of disclosing Morgan Stanley's advice. Testimony
28 regarding Ex. 5028 and Morgan Stanley's role in the
Transaction are not sealed. Duplicate versions of Ex. 5028
designated as Ex. AB and Ex. 66, also remain sealed. See
Docket no. 490.

1 positive theoretical equity value which nVidia might derive in
2 a merger. Ex. CB, ¶¶14-15.

3 One part of the Project Titan Materials suggested a
4 hypothetical net equity value for 3dfx between \$50 million to
5 \$125 million. This net equity value, in a merger context, was
6 premised on (i) assigning a value of \$1 million to \$1.5
7 million per engineer for 75 - 100 engineers; (ii) the present
8 value of a net operating loss tax shield of \$12 million; (iii)
9 a negative net asset value of \$27 million; and (iv) closing
10 and transaction costs of \$10 million. In a section entitled
11 "Transaction Headcount Multiples," Morgan Stanley provided a
12 summary of seven change of control transactions involving
13 technology companies for which a "per engineer" value for the
14 acquisition or merger was derived based on the reported
15 transaction price. The explanation for this data stated
16 "[a]ssuming that 50% of the aggregate value is based on
17 technology value, an appropriate aggregate value/engineer
18 multiple would be in the range of \$1.00MM - \$1.5MM." Ex.
19 5028, p. 13.

20 Mr. Waissar testified that because of 3dfx's financial
21 condition, Morgan Stanley could not implement a discounted
22 cash flow valuation of the business, a net income analysis, an
23 operating income analysis, a gross margin analysis or a
24 revenue analysis. Instead, Morgan Stanley relied primarily on
25 the "theoretical valuation of intangibles." Mr. Waissar
26 testified that this approach is removed from a profit and loss
27 analysis, which will typically yield more reliable data. This
28 preliminary valuation analysis was intended to give nVidia

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1 certain parameters which it could use to consider what a
2 merger with 3dfx might be worth to nVidia. Ex. CB, ¶¶15-17.

3 **3. Competing Offers: Via Technologies, Inc. and nVidia**

4 As a result of the combined efforts of Robertson Stephens
5 and 3dfx management, two offers emerged: one from Via
6 Technologies, Inc. ("Via") and one from nVidia.⁸

7 The December 7, 2000 Via term sheet describes an
8 investment of a total of \$40 million in secured convertible
9 notes, with \$15 million to be funded upon signing definitive
10 documents and an additional \$25 million to be funded on
11 completion of certain engineering milestones. The \$15 million
12 was to be secured by essentially all assets of 3dfx. Under
13 the Via proposal, 3dfx was required to terminate the add-in
14 board business, dismiss a large number of employees and
15 deliver a new chip design by a specified deadline. Ex. G; Ex.
16 BV, ¶19.

17 The December 7, 2000 nVidia term sheet describes an offer
18 to purchase selected graphics chip assets for \$100 million
19 cash, subject to the limitation that a minimum of fifty-six of
20 3dfx's selected employees would accept employment offers from
21 nVidia. If fewer than fifty-six accepted offers, there would
22 be a \$1 million per employee reduction in the purchase price.

23 _____
24 ⁸ Robertson Stephens had apparently advised interested
25 parties that bids had to be submitted by December 4, 2000 and
26 agreement had to be reached by December 15, 2000. Mr. Waissar
27 testified that he understood there were two reasons for this:
28 3dfx was in deteriorating financial condition and 3dfx had
postponed announcing its quarterly financial results until
December 15, 2000. Ex. CB, ¶11; Ex. 5060, p. 43; Ex. CE, ¶31.
nVidia's first term sheet was submitted in accordance with a
December 4, 2000 deadline. Ex. 5033.

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1 3dfx was to continue to exist following the closing and,
2 pending the closing, the parties would enter into an employee
3 services agreement pursuant to which nVidia would pay the
4 salaries of certain 3dfx engineers while they worked on nVidia
5 projects (the "Employee Services Agreement"). The term sheet
6 also provided that the definitive agreement would contain a
7 provision requiring 3dfx to apply the cash proceeds in a
8 manner acceptable to nVidia. To implement this, a portion of
9 the purchase price would be held in escrow following the
10 closing. Ex. BD; Ex. CE, ¶20.

11 On December 9, 2000, the 3dfx board met to consider the
12 competing offers from Via and nVidia. The 3dfx board minutes
13 set the stage as follows:

14 Given the fact that the company had no imminent
15 production, over 700 creditors, a significant monthly
16 cash burn rate and approximately \$60 million in debt . .
17 . the board of directors recognized that the company's
18 precarious financial condition made it increasingly
19 unlikely in the near term that it would be able to pay
20 its debts as they become due and payable.

21 Ex. 5039.

22 The board first selected the Via proposal. However, one
23 of the 3dfx board members informed nVidia that nVidia had time
24 to submit a revised offer.⁹ Ex. BV, ¶8; Ex. BT, ¶¶18-19.

25 On December 10, nVidia submitted a revised proposal which
26 the 3dfx board voted to accept. Described in a term sheet
27 dated December 11, 2000, this offer provided, *inter alia*, that
28 (i) nVidia would purchase certain graphics related assets for

29 ⁹Via was advised of this turn of events but dropped out
30 of the bidding at this point. Ex. BV, ¶31.

1 \$60 million cash and one million shares of nVidia common stock
2 deliverable when 3dfx satisfied its liabilities and
3 obligations; (ii) 3dfx could monetize a portion of the stock
4 consideration if it certified that the monetization would
5 enable 3dfx to satisfy all of its liabilities and obligations;
6 (iii) 3dfx would continue as a stand-alone entity; (iv) nVidia
7 would provide a \$15 million bridge loan to be funded upon
8 signing; (v) nVidia would set up a \$15 million fund earmarked
9 to pay bonuses for engineers who accepted nVidia's employment
10 offers; (vi) following execution of definitive documents,
11 nVidia would deliver to 3dfx two lists of selected 3dfx
12 employees to whom nVidia intended to offer employment; and
13 (vii) the parties would enter into an Employee Services
14 Agreement so that prior to the closing, 3dfx employees would
15 work on nVidia projects at nVidia's expense. Ex. 5041; Ex.
16 BT, ¶20; Ex. CE, ¶24.

17 **D. The Asset Purchase Agreement**

18 **1. Documentation for the Transaction**

19 Following the 3dfx board decision to accept the nVidia
20 offer, certain terms of the proposed asset purchase continued
21 to evolve. The final documentation for the Transaction
22 included, *inter alia*, the APA, Voting Agreement, Credit
23 Agreement, Security Agreement, Patent License Agreement,
24 Patent Standstill Agreement, Trademark Assignment Agreement,
25 and a fairness opinion for 3dfx. Exs. 5047-5049.¹⁰

27 ¹⁰ Defined terms used in the APA will be used consistently
28 herein.

1 It is not entirely clear when certain provisions that are
2 in the APA were added or when certain provisions in the
3 December 11, 2000 term sheet were deleted from the
4 Transaction. For example, nVidia's counsel Paul Carmichael
5 testified that early in the negotiations, nVidia proposed that
6 the parties dismiss the Patent Litigation upon signing the
7 APA. 3dfx proposed that the Patent Litigation be dismissed
8 upon closing of the Transaction and this is what the APA
9 provides. Ex. CA, ¶27; Ex. 5047, p. 7. It is also unclear
10 when 3dfx made the decision to dissolve pursuant to its Plan
11 of Dissolution (as described in the APA). Ex. CA, ¶19; Ex.
12 5047, p. 1; Ex. 5060, p. 56. The Employee Services Agreement,
13 described in early term sheets, was apparently deleted shortly
14 before signing the APA on December 15, 2000, as was the \$15
15 million bonus fund earmarked for the payment of bonuses to
16 engineers. The cash was also increased from \$60 million to
17 \$70 million. Ex. 5035; Ex. BD; Ex. 5041; Ex. CE, ¶27; RT 651-
18 653, 734.

19 Certain provisions of the APA are relevant for a
20 determination of the issues under consideration at this phase
21 of the case.

22 Section 1.1 describes the Specified Assets to be sold as
23 all of the properties, rights, interests, and other
24 tangible and intangible assets (wherever located and
25 whether or not required to be reflected on a balance
26 sheet prepared in accordance with GAAP) . . . that are or
were used in . . . or that otherwise directly or
indirectly related to, the graphics business of the
Seller Corporations (the 'Graphics Business').

27 Ex. 5047, p. 1.

28 3dfx is defined as the Seller and 3dfx and its

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1 subsidiaries are defined as the Seller Corporations. Ex.
2 5047, pp. 1, A-6.

3 The Specified Assets are defined in § 1.1(a)-(i). The
4 Specified Assets include, *inter alia*, (a) Patents, Patent
5 Applications, Trademarks, Tradenames; (b) Other Proprietary
6 Assets, (defined as all Proprietary Assets and goodwill of the
7 Seller Corporations, copyrights, trade secrets, know-how,
8 computer software, inventions, designs, drawings, existing and
9 in-development chip designs and related specifications, source
10 codes, verification and validation environments, manufacturing
11 specifications and databases, in-process research and
12 development, product reviews); (c) Inventory, Equipment, and
13 Other Tangible Assets; (d) Contracts; (e) Governmental
14 Authorizations; (f) Claims; (g) Other Assets (defined as
15 including existing and in development chip designs, related
16 specifications, source codes, customer lists); (h) Books and
17 Records; and (i) Proceeds. Ex. 5047, pp. 1-3. (The Court
18 will refer to the assets defined in §§ 1.1(a), (b), (g), (h)
19 as the Intellectual Property Assets.)

20 The APA also defines the Excluded Assets as those assets
21 on Exhibit C (subject to the Closing Agreement) that directly
22 and exclusively relate to the graphics board business of the
23 Seller. Ex. 5047, p. A-3. The Excluded Assets on Exhibit C
24 include the stock of the Seller Corporations, cash, and
25 accounts receivable. Ex. 5047, p. nv45374.

26 Sections 1.2 and 1.3 of the APA describe the payment
27 terms. In summary, nVidia agreed to pay \$70 million cash at
28 Closing (the "Cash Consideration"), and subject to the

1 conditions in § 1.3, to deliver one million shares of nVidia
2 common stock (the "Stock Consideration"). The essential
3 restriction on the Stock Consideration was that the Stock
4 Consideration was only deliverable upon completion of the
5 winding up of the business of 3dfx pursuant to its Plan of
6 Dissolution and upon certification that all Liabilities of the
7 Seller Corporations had been paid in full or otherwise
8 provided for in a manner satisfactory to nVidia. Upon certain
9 conditions, 3dfx was permitted to obtain an advance on the
10 Stock Consideration by monetizing up to a maximum of \$25
11 million if this monetization was necessary and sufficient to
12 enable 3dfx to pay its Liabilities in full. Ex. 5047, pp. 3-
13 4.

14 Section 1.5 of the APA describes the \$15 million credit
15 facility and the non-exclusive, perpetual fully-paid license
16 for all of the Patents (other than those involved in the
17 Patent Litigation) and the sale of the Trademarks and
18 Trademark Applications given in exchange for this bridge
19 financing. Section 1.6 provides for the stay of the Patent
20 Litigation pending closing. Ex. 5047, pp. 5-6.

21 Section 2.5 of the APA provides that the Specified Assets
22 collectively constitute all of the properties, rights,
23 interests and other tangible and intangible assets necessary
24 to enable the Seller to conduct the Graphics Business in the
25 manner in which the Graphics Business is currently being
26 conducted and in the manner in which the Graphics Business is
27 proposed to be conducted. Ex. 5047, p. 11.

28 Section 2.16 of the APA provides that the Disclosure

1 Schedule accurately sets forth information regarding the
2 employees of the Seller Corporations who perform services
3 related to the Specified Assets or the Graphics Business. Ex.
4 5047, pp. 18-19. Schedule 2.16, dated December 15, 2000,
5 lists approximately 300 names with salary information, but a
6 later version of Schedule 2.16 states that after December 15,
7 2000, substantially all of Seller's employees were terminated.
8 Ex. 5047, pp. nv45411-45418, nv45619-45626.

9 Section 4 of the APA describes the pre-closing covenants
10 of 3dfx. Section 4.2(a) provides, in pertinent part, that
11 3dfx will: (i) preserve intact the current business
12 organization relating to the Specified Assets and the Graphics
13 Business; (ii) keep available the services of current
14 employees relating to the Specified Assets and the Graphics
15 Business; and (iii) maintain good relations and goodwill with
16 all suppliers, customers, landlords, creditors, employees.
17 Ex. 5047, pp. 26-28.

18 **2. nVidia's Perspective Regarding the Transaction**

19 Mr. Huang, nVidia's chief executive officer, testified
20 that when nVidia first started discussing a possible
21 transaction with 3dfx, nVidia believed that 3dfx would remain
22 in the add-in board business and structured its first proposal
23 on terms that would have made nVidia the exclusive supplier of
24 chips to 3dfx. Because such a structure meant that 3dfx would
25 no longer need engineers to design graphics chips, nVidia
26 hoped to be able to hire a number of the best of them.
27 However, because engineers were in short supply, nVidia also
28 believed that the engineers would be in high demand by other

1 companies and nVidia wanted to be able to recruit them before
2 other companies did. Ex. BT, ¶12.

3 In late November and early December 2000, nVidia had asked for
4 and obtained two lists of the 3dfx engineers containing
5 information about their compensation and Phil Carmack's¹¹
6 subjective assessment of their skills. Exs. 142, 162; Ex. BU,
7 ¶¶16-17.

8 According to Mr. Huang, hiring the 3dfx engineers was the
9 true value of the Transaction. He testified that the purchase
10 price that nVidia agreed to pay had nothing to do with any
11 attempt to value the assets that 3dfx was selling to nVidia.
12 nVidia did not conduct a formal appraisal of the assets before
13 signing the APA because the value of the assets was not what
14 drove nVidia's interest in doing the deal or the purchase
15 price. According to Mr. Huang:

16 The total consideration was competitively driven, i.e.,
17 what 3dfx management was willing to accept, what we felt
18 we could afford, and what it took to beat out Via. It
19 was very competitive because 3dfx had business
20 relationships with Via; in the past there had been talks
21 of partnership arrangements. What was important to
22 nVidia in this transaction was not the value of the
23 assets that we were buying, but the opportunity to be
24 first in line to recruit the 3dfx design engineers. We
25 were willing to pay a premium over the value of 3dfx's
26 assets to get that head start over other potential
27 suitors for the 3dfx engineers.

28 Ex. BT, ¶¶24-25.

Mr. Huang also testified that when it was apparent that

¹¹ Phil Carmack, vice president of hardware engineering at 3dfx until 1998, at Gigapixel in 1999, and again at 3dfx as executive vice president of research and development following the Gigapixel merger. He became an nVidia employee following the Transaction. Ex. BU, ¶¶7, 21-25.

1 3dfx planned to dissolve after the Transaction, nVidia wanted
2 to be sure that any dissolution was completed in a way that
3 did no harm to nVidia, or to nVidia's reputation for fair
4 dealing in the market, and did no harm to the creditors that
5 nVidia and 3dfx had in common. Ex. BT, ¶37.

6 nVidia originally proposed to escrow the Stock
7 Consideration until 3dfx could certify that its creditors had
8 been paid in full. However, 3dfx wanted to be able to use the
9 Stock Consideration to pay its creditors. Because nVidia
10 wanted to use the Stock Consideration to motivate 3dfx to
11 complete the transaction quickly, nVidia agreed to let 3dfx
12 monetize an agreed maximum amount of \$25 million to pay
13 creditors if 3dfx could certify that doing so would result in
14 full payment of its Liabilities. Ex. BT, ¶27.

15 **E. Events Following December 15, 2000**

16 **1. 3dfx Announces the Transaction and the Termination of**
17 **Employees**

18 On Friday, December 15, 2000, the parties signed the APA
19 and 3dfx management announced to its employees that the
20 company was shutting down and the employees would be
21 terminated. Ex. BV, ¶39. Phil Carmack testified that on
22 December 15, 2000, he received written notification that he
23 was being laid off. He understood that his colleagues also
24 received this layoff notice. On December 18, 2000, he
25 attended a presentation made by nVidia to certain of the
26 engineers at which nVidia presented employment offers. Ex.
27 BU, ¶¶20-24.

28 Mr. Huang testified that he and other members of nVidia's

1 management met with 3dfx employees in Northern California on
2 December 18, 2000 and then flew to Texas to meet with
3 employees there. Ex. BT, ¶33. nVidia representatives met
4 individually with the 3dfx employees nVidia wanted to recruit
5 and made offers to approximately 120 of them. These offers
6 included 10 percent pay increases, stock options and
7 incentives to accept promptly. Ex. BT, ¶33; Ex. CE, ¶¶35-37.

8 Mr. Huang was confident that he would be able to persuade
9 3dfx engineers to accept nVidia's offers. RT 131, RT 167-168.
10 Consistent with Mr. Leupp's view of historical animosity
11 between the two groups of engineers, Christine Hoberg,
12 nVidia's chief financial officer at the time, testified that
13 other members of nVidia management did not share Mr. Huang's
14 confidence and were very nervous about the recruiting process.
15 She testified that some of the engineers viewed Mr. Huang as
16 Darth Vader. RT 768.

17 nVidia ultimately hired 107 former 3dfx employees, most
18 of whom were engineers. They began working at nVidia in early
19 January 2001. Ex. BU, ¶¶19-25; Ex. BT, ¶¶33-34.

20 **2. nVidia Obtains Regulatory Approval**

21 In order to obtain the required regulatory approval of
22 the Transaction,¹² nVidia filed a Notification and Report Form
23 for Certain Mergers and Acquisitions with the Department of
24 Justice and the Federal Trade Commission as required by the
25 Hart-Scott-Rodino Antitrust Improvement Act of 1976 (the "HSR
26

27 ¹² Section 7A of the Clayton Act, 15 U.S.C. § 18a (1996),
28 and the rules promulgated thereunder.

1 Notification"). Ex. 84.

2 Pursuant to § 801.10 of the Code of Federal Regulations,
3 the value of the assets listed on the HSR Notification is to
4 be either the fair market value or the acquisition price, if
5 the acquisition price has been determined and if it is greater
6 than the fair market value. 16 C.F.R. § 801.10 (2002). The
7 HSR Notification states that nVidia is acquiring certain
8 assets of 3dfx relating to its graphics business with an
9 approximate value of \$108 million. The \$108 million was based
10 on the \$70 million in Cash Consideration and the value of the
11 Stock Consideration as of December 15, 2000. Ex. 5064, p. 8.
12 After approximately 30 days, nVidia obtained regulatory
13 approval of the Transaction. Ex. 213.

14 **3. Deloitte & Touche LLP and KPMG LLP: nVidia's**
15 **Accounting for the Transaction**

16 In December 2000, nVidia retained Deloitte & Touche LLP
17 ("D&T") to assist it with its allocation of the purchase price
18 to the assets acquired on a fair value basis for financial
19 reporting purposes. D&T produced a report dated May 3, 2001
20 (the "D&T Report"). Ex. 5064. Based upon the sum of the Cash
21 Consideration and the Stock Consideration it anticipated would
22 be paid, nVidia management told D&T that the fair value of the
23 assets to be acquired from 3dfx was approximately \$107.4
24 million. Ex. 5064, p. 8. The phrase "fair value" used in the
25 D&T Report was the standard accounting definition for the
26 purchase price paid by a willing buyer to a willing seller.
27 Ex. CD, ¶7; Ex. U, pp. 71, 188-189.

28 nVidia management advised D&T that the net book value of

1 the Inventory, Equipment and Other Tangible Assets was \$2.4
2 million. D&T believed this was reasonably representative of
3 the fair value of these assets and used this figure in its
4 purchase price allocation. Ex. 5064, p. 25.

5 D&T attempted to allocate the remaining consideration
6 (\$105 million) to intangible assets consisting of: (i) an
7 assembled workforce; (ii) Patents; (iii) Trademarks and Trade
8 Names; (iv) other intangibles in the nature of goodwill; (v)
9 developed technology; and (vi) in-process research and
10 development. D&T concluded that the material contributory
11 intangible assets were an assembled workforce, and Trademarks
12 and Trade Names. Ex. 5064, p. 28.

13 Based on discussions with nVidia management concerning
14 the composition of the assembled workforce, D&T determined
15 that its value would likely be material enough to warrant its
16 valuation for allocation purposes. D&T allocated \$3 million
17 to an assembled workforce of 107 employees based on the
18 avoided cost of recruiting this many high-caliber employees.
19 Ex. 5064, p. 28. Mark Maxson, the D&T principal in charge of
20 the engagement, testified that there was economic benefit in
21 this opportunity to recruit the 3dfx engineers and the D&T
22 Report referred to this opportunity to recruit as an assembled
23 workforce. Ex. CD, ¶11; Ex. 5064, pp. 20, 28.

24 D&T also believed that the 3dfx Trademark and Tradename
25 portfolio was sufficiently established and recognized by
26 retail consumers to justify attaching a value to it. D&T used
27 the income approach and assigned a fair value of \$11.310
28 million to the Trademark portfolio. Ex. 5064, pp. 31-32.

[3dfx.nvidia.decis.4.08.]

-26-

1 D&T attempted to allocate purchase price to the Patents
2 and Patent Applications. nVidia management did not expect the
3 Patents to generate any material third party license revenue
4 and D&T stated that it could not attribute specific cash flows
5 to the Patents due to the primarily defensive nature of the
6 portfolio. D&T thus concluded that it could not estimate the
7 value of the Patents with reasonable reliability. Ex. 5064,
8 p. 31.

9 D&T also analyzed developed technology assets (described
10 as proprietary assets, including trade secrets, source codes,
11 and designs for existing chips) and in-process research and
12 development (described as development assets not currently
13 technologically feasible). D&T could not attribute individual
14 cash flows to these assets, however, because nVidia had
15 indicated it had no strategy to sell, lease, market or make
16 alternative use of them. Accordingly, D&T concluded that the
17 value of these assets was "inseparable from goodwill." Ex.
18 5064, p. 33.

19 Based on the \$3 million allocated to avoided recruiting
20 costs for the workforce, and the \$11,310,000 allocated to
21 Trademarks and Tradenames, D&T determined that the total fair
22 value of the "identifiable intangible assets" was \$14,310,000
23 and the fair value allocated to the tangible assets was
24 \$2,432,500. The remainder of the \$107,437,500 assumed
25 purchase price - \$90.695 million - was allocated to
26 "goodwill." The D&T Report defined goodwill as the "residual
27 amount remaining unallocated to an identifiable intangible
28 asset." Ex. 5064, p. 3.

1 Mr. Maxson testified that D&T had no role in establishing
2 the amount agreed to be paid by nVidia - D&T's only role was
3 to assist in the accounting exercise that ended with the \$90
4 million residual amount the D&T Report described as goodwill.

5 Mr. Maxson stated:

6 [T]he accounting concept [of] goodwill is usually an
7 overpayment or synergies that are unique to the buyer,
8 which is what causes [it] - excess purchase price is
9 another term that's used sometimes . . . and that means
10 consideration or deal value above and beyond the items
11 that were actually received.

12 RT 1371. Mr. Maxson also testified that the \$90 million in
13 the goodwill category was a "residual number" and was not an
14 opinion of the value of goodwill. RT 1371; Ex. CD, ¶16.

15 At some point in the due diligence process, nVidia
16 retained the accounting firm KPMG LLP ("KPMG") to assist it in
17 performing due diligence in connection with the Transaction.
18 KPMG advised nVidia that applicable GAAP and SEC Rules¹³
19 required nVidia to account for the Transaction as the
20 acquisition of a business. This meant that nVidia had to
21 include pro forma financial statements in the Form S-4
22 Registration Statement which was to be filed in January 2001.
23 Exs. 5057, 5060.

24 Michael Dance, the KPMG audit partner, testified that if

25 ¹³ See Determining Whether a Nonmonetary Transaction
26 Involves Receipt of Productive Assets or of a Business, Issue
27 No. 98-3 (2000) (Emerging Issues Task Force) ("EITF No. 98-3")
28 and Pro Forma Financial Statement Preparation Requirements,
SEC Reg. S-X, Rule 11-01, 17 C.F.R. § 210.11-02(a) (2008).
The EITF was formed by the SEC and the FASB in order to
consider and respond to new issues in accounting practice. An
EITF consensus is made part of GAAP until a later FASB
pronouncement supersedes it. Ex. BX, ¶¶14, 16-17; Ex. P.

1 acquired assets had the ability to generate revenues, the pro
2 forma information illuminated a transaction's continuing
3 impact on the buyer's financial statements. In his view,
4 D&T's allocation of purchase price to goodwill and Trademarks
5 implied an ability to generate revenues and the allocation of
6 purchase price to a workforce implied an ability to conduct
7 business activities. Ex. 274(d), pp. 35:9-15; 42:21-25; 43:1-
8 6; 54:1-10; 57:16-24; 58:1-11; 68:15-17; 71:23-72:1-12; Ex. T.

9 **4. The Closing**

10 On March 27, 2001, 3dfx held its annual shareholders'
11 meeting at which 3dfx obtained shareholder approval of the APA
12 and the Plan of Dissolution. Ex. 5060; Ex. BV, ¶¶40-42.

13 nVidia believed it had no obligation to close the
14 Transaction because certain of the 3dfx representations and
15 warranties in the APA were inaccurate. Ex. BT, ¶¶35-37.
16 Nonetheless, the parties entered into a Closing Agreement
17 pursuant to which nVidia paid the remaining \$55 million in
18 Cash Consideration and the Transaction closed on April 19,
19 2001. Ex. 5049, p. nv45010-45019; Ex. CE, ¶¶43-45. The
20 parties also dismissed the Patent Litigation as the APA
21 contemplated. Ex. 5049, p. nv45082-45087. The Stock
22 Consideration was not provided to 3dfx due to the fact that it
23 did not satisfy the conditions stated in § 1.3 of the APA.
24 Ex. 5047, pp. 3-4.

25 Mr. Huang testified that by April of 2001, nVidia had
26 substantially realized the benefits it had hoped to achieve
27 from the Transaction. nVidia had succeeded in hiring about
28 100 engineers, and in exchange for funding the \$15 million

1 bridge loan, had received an assignment of 3dfx's Trademarks
2 and Tradenames, and an irrevocable license to all of 3dfx's
3 Patents (other than those at issue in the Patent Litigation).
4 Ex. BT, ¶¶35-37.

5 Mr. Huang stated that nVidia paid the balance of the Cash
6 Consideration because it was important that nVidia be viewed
7 in the marketplace as a fair company and nVidia wanted to do
8 what it could to assure that 3dfx paid its creditors, several
9 of whom were nVidia's key suppliers. Ex. BT, ¶¶35-37.

10 **II. JURISDICTION**

11 The Court has jurisdiction over this adversary proceeding
12 pursuant to 28 U.S.C. §§ 1334(b) and 157(b)(2)(A), (E), (H)
13 and (O).

14 **III. DISCUSSION**

15 **A. Introduction**

16 The Trustee contends that the APA transferred to nVidia
17 3dfx's *graphics business or business unit*, its *organized*
18 *workforce*, and the economic goodwill *embedded in, attached to*
19 *or associated with* that workforce. The Trustee's valuation
20 expert contends these assets had a fair market value of at
21 least \$140 million. Accordingly, the Trustee claims the \$70
22 million nVidia paid was not reasonably equivalent value for
23 what it acquired.

24 nVidia argues that nVidia purchased only certain tangible
25 and intangible assets and settled the Patent Litigation.
26 According to nVidia's experts, these tangible and intangible
27 assets and the settlement of the Patent Litigation had a fair
28 market value of \$13.4 million. nVidia paid \$70 million for

1 its own strategic reasons and because nVidia believed it was
2 in a competitive bidding situation and needed to pay this
3 amount to achieve its goals. nVidia asserts that it did not
4 purchase a graphics business because, among other reasons,
5 3dfx did not have one at the time of the Transaction. nVidia
6 also contends that it did not acquire an organized workforce
7 through the Transaction because outside the APA, nVidia
8 individually recruited only certain of 3dfx's former engineers
9 whose employment was terminated by 3dfx. nVidia also argues
10 that engineers are not assets under fraudulent conveyance
11 analysis.

12 The Trustee's theory of this case appears to be premised
13 in part on a belief that the basic deal structure agreed to by
14 the principals of 3dfx and nVidia was fundamentally unfair.
15 This belief turns on the fact that the Stock Consideration was
16 only deliverable when 3dfx certified that its creditors had
17 been paid and the fact that only \$25 million of the Stock
18 Consideration could be monetized to pay creditors. The
19 Trustee argues that this structure favored shareholders at the
20 expense of creditors and that nVidia knew the \$70 million in
21 Cash Consideration and the additional \$25 million available
22 from the Stock Consideration was insufficient for 3dfx to
23 satisfy its Liabilities.¹⁴

24 The Court notes that the Trustee sued certain former
25

26 ¹⁴Mr. Huang testified that it was 3dfx management that
27 wanted the Stock Consideration. RT 510-513, 515-522. It is
28 not clear from the record how or when the parties came to
agree on the provision for monetizing part of the Stock
Consideration.

1 officers and directors of 3dfx for breach of fiduciary duty.
2 The Court approved the Trustee's compromise of those claims
3 pursuant to which the Trustee received \$5.5 million in
4 exchange for complete releases. (See Ch. 11 case no. 02-
5 55795-RLE, Docket nos. 480, 496.) The Court also notes that
6 the Trustee did not establish that nVidia knew the available
7 cash would be insufficient for its stated purpose at any
8 relevant point in time.

9 **B. Applicable Law**

10 **1. Civil Code § 3439, et seq.**

11 The Trustee's Complaint is based on California Civil Code
12 § 3439, et seq. applicable herein through Bankruptcy Code
13 § 544(b)(1).

14 Civil Code § 3439.05 provides in pertinent part that:

15 [A] transfer made by a debtor is fraudulent as to a
16 creditor whose claim arose before the transfer was made .
17 . . if the debtor made the transfer . . . without
18 receiving a reasonably equivalent value in exchange for
19 the transfer . . . and the debtor was insolvent at that
20 time or the debtor became insolvent as a result of the
21 transfer[.]

19 Cal. Civ. Code § 3439.05 (West 2008)¹⁵.

20 The UFTA contains a number of definitions relevant to the
21 Court's decision. Civil Code § 3439.01(i) provides that only
22 transfers of "assets" are subject to avoidance. Section
23

24
25 ¹⁵ California fraudulent conveyance law and Bankruptcy
26 Code § 548 are similar in form and substance and both may be
27 analyzed contemporaneously. Accordingly, the Court has relied
28 on cases decided under the UFTA, its predecessor, the Uniform
Fraudulent Conveyance Act, and § 548 of the Bankruptcy Code.
See Wyle v. C.H. Rider & Family (In re United Energy Corp.),
944 F. 2d 589, 594 (9th Cir. 1991).

1 3439.01(a) defines "asset" as "property of the debtor" and
2 "property" is defined in § 3439.01(h) as anything that may be
3 "subject of ownership." Id. Also, the property must be
4 subject to enforcement of a money judgment. See Cal. Civ.
5 Code § 3439.01, (Legis. Committee Comment, Assembly 1986).

6 **2. Reasonably Equivalent Value**

7 In determining whether a transfer has been for an
8 exchange of reasonably equivalent value, the court analyzes
9 all the circumstances surrounding the transfer. 5 Collier on
10 Bankruptcy ¶548.05[1][b] at 548-35 (Alan N. Resnick & Henry J.
11 Sommer eds., 15th ed. rev. 2002); see also Barber v. Golden
12 Seed Co., Inc., 129 F. 3d 382, 387 (7th Cir. 1997) (applying
13 Bankruptcy Code § 548 - reasonable equivalence should depend
14 on all the facts of each case). In Sharp v. Chase Manhattan
15 Bank USA, N.A. (In re Commerical Financial Services, Inc.),
16 350 B.R. 559 (Bankr. N.D. Okla. 2005), the court explained:

17 Generally, the 'totality of the circumstances' test is
18 fact-intensive and may include consideration of fair
19 market value (which may be established by comparable
20 sales, income production capacity or some other valid
21 measure of value), the arms-length nature of the
22 transaction, the economic circumstances and relationship
23 of the parties, the maturity, competitiveness and
24 efficiency of the market, industry standards, and other
25 factors.

26 Id. at 577.

27 The phrase "reasonably equivalent value" is not defined
28 in the UFTA or the Bankruptcy Code. As the court explained in
29 In re Kemmer, 265 B.R. 224 (Bankr. E.D. Cal. 2001), defining
30 reasonably equivalent value has been left to the courts:

31 [t]here is no hard and fast rule in the Ninth Circuit as
32 to what constitutes 'reasonably equivalent value.' The
33 concept of 'reasonable equivalence' is not wholly

1 synonymous with 'market value' even though market value
2 is an extremely important factor to be used in the
court's analysis.

3 Id. at 232 (citation omitted).

4 Because the policy behind fraudulent conveyance law is to
5 preserve assets of the estate, reasonably equivalent value is
6 determined from the standpoint of the estate's creditors, it
7 is not determined from the defendant's perspective. See
8 Frontier Bank v. Brown (In re Northern Merchandise, Inc.), 371
9 F. 3d 1056, 1059 (9th Cir. 2004) (citing Harman v. First Am.
10 Bank (In re Jeffrey Bigelow Design Group, Inc.), 956 F. 2d
11 479, 484 (4th Cir. 1992)) (primary focus is on the net effect
12 of the transaction on the debtor's estate and the funds
13 available to pay the unsecured creditors); Gill v. Maddalena
14 (In re Maddalena), 176 B.R. 551, 555 (Bankr. C.D. Cal. 1995)
15 (debtor's creditors suffered a significant net loss in
16 comparing the value of what was transferred by debtor to the
17 value of what he received in exchange); Pajaro Dunes Rental
18 Agency, Inc. v. Spitters (In re Pajaro Dunes Rental Agency,
19 Inc.), 174 B.R. 557, 578 (Bankr. N.D. Cal. 1994) (reasonable
20 equivalence analysis is from perspective of creditors of the
21 estate); In re Consol. Capital Equities Corp., 143 B.R. 80, 87
22 (Bankr. N.D. Tex. 1992) (citing Kirkland v. Rizzo, 98 Cal.
23 App. 3d 971 (Ct. App. 1 Dist. 2 Div. 1979)) (applying
24 California law, when analyzing the fairness of consideration
25 the court assumes a creditor's perspective).

26 Finally, as the court noted in Pajaro Dunes, if it is
27 necessary for a just result, the court may construe a
28 segmented transaction as one transaction. In re Pajaro Dunes

1 Rental Agency, Inc., 174 B.R. at 584. The court need not
2 allow the labels put on a transaction by the interested
3 parties to control the rights of third parties. Id. at 584-85
4 (citing Douglas G. Baird & Thomas H. Jackson, Fraudulent
5 Conveyance Law, 38 Vand. L. Rev. 829 (1985)).

6 **3. Burden of Proof**

7 Under both the UFTA and Bankruptcy Code § 548, the
8 Trustee has the burden of proving the elements of a fraudulent
9 transfer by a preponderance of the evidence. Whitehouse v.
10 Six Corp., 40 Cal. App. 4th at 534; 5 Collier on Bankruptcy
11 ¶548.10 at 548-80.5.

12 While the burden of proof itself does not shift, during
13 the progress of the case, the burden of going forward with the
14 evidence to rebut a prima facie case may shift. See
15 Braunstein v. Walsh (In re Rowanoak Corp.), 344 F. 3d 126, 131
16 (1st Cir. 2003) (burden of proof does not shift but duty of
17 going forward may shift if trustee establishes prima facie
18 case); Whitehouse v. Six Corp., 40 Cal. App. 4th at 534
19 (applying UFTA, plaintiff has burden of proof but burden
20 shifts to defendant upon threshold showing of less than
21 reasonably equivalent value); 5 Collier on Bankruptcy ¶548.10
22 at 548-80.5-81.

23 To establish his prima facie case, the Trustee must prove
24 what was transferred, that what was transferred is subject to
25 avoidance under applicable law, and the fair market value of
26 what was transferred or surrendered. By comparing the fair
27 market value of the property transferred to what was received,
28 the Trustee may establish that 3dfx did not receive a

1 reasonably equivalent value in exchange. See In re Maddalena,
2 176 B.R. at 553-54.

3 The Trustee contends that the Summary Judgment Order
4 establishes his prima facie case that the *assets* transferred
5 to nVidia had a fair market value of at least \$108 million.¹⁶
6 The Trustee also contends that he proved at trial that the
7 *assets* actually transferred to nVidia included a workforce,
8 intellectual property and goodwill with a fair market value of
9 \$140 million. From this contention, the Trustee argues in his
10 Post-Trial Brief that the burden shifted to nVidia to show
11 "that assets not subject to the fraudulent conveyance law were
12 included in the assets acquired and the value of those
13 assets." Docket no. 452, Trustee's Post-Trial Brief, p. 8.

14 The Summary Judgment Order does not establish the
15 Trustee's prima facie case, nor does it shift the burden of
16 production or burden of proof to nVidia. The Summary Judgment
17 Order simply says that nVidia may not claim that the
18 *transaction value* is something other than \$108 million. To
19 the extent this may be unclear, the Court may use its inherent
20 authority to interpret its orders. See In re Menk, 241 B.R.
21 896, 906 (9th Cir. BAP 1999) (citing Beneficial Trust Deeds v.
22 Franklin (In re Franklin), 802 F.2d 324, 326-27 (9th Cir.
23 1986)); Koehler v. Grant, 213 B.R. 567, 569 (8th Cir. BAP
24 1997) (bankruptcy court retains subject matter jurisdiction to
25 interpret orders entered prior to dismissal); see also In re
26

27 ¹⁶This argument is based on the fact that nVidia stated
28 \$108 million in the HSR Notification.

1 United States Brass Corp., 255 B.R. 189, 192 (Bankr. E.D. Tex.
2 2000), aff'd 301 F. 3d 296 (5th Cir. 2002) (bankruptcy court
3 has jurisdiction to clarify and enforce its own orders). The
4 Court's Summary Judgment Order does not set a floor of \$108
5 million for valuation purposes and does not shift the burden
6 of production or proof to nVidia.¹⁷ It simply provides that
7 nVidia may not claim that the *transaction* value is something
8 other than \$108 million and nVidia does not make such a claim.

9 **4. Valuation Principles**

10 In dealing with the conflicting views of the valuation
11 experts, this Court finds the analysis of the court in Peltz
12 v. Hatten, 279 B.R. 710, 737-738 (D. Del. 2002), aff'd sub
13 nom., In re USN Comm., Inc., 60 Fed. Appx. 401 (3rd Cir. 2003)
14 both wise and instructive:

15 First, it is clear that experts and industry analysts
16 often disagree on the appropriate valuation of corporate
17 properties, even when employing the same analytical tools
18 such as a [discounted cash flow] analysis or a comparable
19 sales method. Simply put, when it comes to valuation
20 issues, reasonable minds can and often do disagree. This
21 is because the output of financial valuation models are
22 driven by their inputs, many of which are subjective in
23 nature. . . . Second, in determining whether a value is
24 objectively "reasonable" the court gives significant
25 deference to marketplace values. When sophisticated
26 parties make reasoned judgments about the value of assets
27 that are supported by then prevailing marketplace values
28 and by the reasonable perceptions about growth, risks,
and the market at the time, it is not the place of
fraudulent transfer law to reevaluate or question those
transactions with the benefit of hindsight.

24 Id. at 737 (citations omitted). This Court will view the

26 ¹⁷ See Declaration of John Sipple filed in support of
27 nVidia's Opposition to Trustee's Motion for Summary Judgment
28 explaining context for the HSR Notification and how it is used
to assess potential impact on competition. Docket no. 139.

1 evidence on fair market value and reasonably equivalent value
2 through this philosophical lens.

3 The valuation experts, Roger Grabowski¹⁸ for nVidia, and
4 Michael Wagner¹⁹ for the Trustee, had appropriate credentials
5 for the task and agreed on many fundamental valuation
6 principles. Mr. Wagner and Mr. Grabowski agreed that the
7 overarching objective of the valuation exercise was to predict
8 the most probable price at which the assets would have been
9 sold in the applicable competitive open market on the
10 valuation date under conditions requisite to a fair sale.
11 They both defined fair market value as the price expressed in
12 terms of cash equivalents at which property would change hands
13 between a hypothetical willing and able buyer and a
14 hypothetical willing and able seller, acting at arms length in
15 an open and unrestricted market, when neither is under
16 compulsion to buy or sell and both have reasonable knowledge
17 of relevant facts. Ex. 43, ¶6; Ex. BW, ¶11; RT 918-924.

18 Mr. Grabowski and Mr. Wagner also agreed that Robertson
19 Stephens had done a competent and thorough job of seeking out
20 any and all investors or purchasers for 3dfx, in whole or in
21 part, and would have been able to solicit the most likely
22 prospective buyers or investors in the market as it existed at

24 ¹⁸ See Appendix C to Ex. BW for complete details regarding
25 his credentials. In brief, Mr. Grabowski is Managing
26 Director, Standard and Poor's Corporate Value Consulting,
Chicago.

27 ¹⁹ See Ex. 2 to Ex. 43 for complete details regarding his
28 credentials. In brief, Mr. Wagner is Senior Advisor at
Charles River Associates, Inc.

1 that time. In other words, they agreed that an appropriate
2 market exposure had taken place. Ex. Q, pp. 4, 14-15; RT 925-
3 929. See also Ex. AC, pp. 9-14.

4 **5. The Use of Generally Accepted Accounting Principles**

5 One of the cornerstones of the Trustee's theory of this
6 case is that nVidia accounted for the Transaction as the
7 purchase of a business under generally accepted accounting
8 principles ("GAAP") so the Court must find that the
9 Transaction was the purchase of a business for fraudulent
10 conveyance purposes.²⁰

11 Parties to avoidance actions who have taken the Trustee's
12 approach that GAAP dictate a bankruptcy court's determination
13 of solvency, have generally been unsuccessful. See Arrow
14 Electronics, Inc. v. Justus (In re Kaypro), 230 B.R. 400, 413
15 (9th Cir. BAP 1999) aff'd in part rev'd in part, 218 F. 3d
16 1070 (9th Cir. 2000) (GAAP relevant but not controlling in
17 insolvency determinations); Sierra Steel, Inc. v. Totten
18 Tubes, Inc. (In re Sierra Steel, Inc.), 96 B.R. 275, 278 (9th
19 Cir. BAP 1989) (court is to make determination of solvency,
20 not accountants and board which promulgates GAAP); Kendall v.
21 Sorani (In re Richmond Produce Co., Inc.), 151 B.R. 1012, 1019
22 (Bankr. N.D. Cal. 1993), aff'd, 195 B.R. 455 (N.D. Cal. 1996)

24 ²⁰ In 2002 nVidia told the SEC: "The purchase of certain
25 assets of 3dfx constituted the purchase of a 'business' as
26 defined by EITF 98-3 . . . [the engineers] had the ability to
27 continue business activities they conducted before the
28 acquisition. . . nVidia obtained the critical elements of a
business (i.e., long lived assets, intellectual property,
trademarks and an organized skilled workforce . . ." Ex.
5086.

1 (GAAP do not control solvency determination, solvency inquiry
2 must be to what extent an asset would have value for a
3 creditor attempting to satisfy its claim, goodwill can not be
4 sold to satisfy creditor's claim).

5 In EBC I, Inc. v. America Online, Inc. (In re EBC I,
6 Inc.), 380 B.R. 348 (Bankr. D. Del. 2008) both parties in a
7 fraudulent conveyance action cited to IRS Revenue Procedure
8 77-12 to support their arguments about valuing the inventory
9 of a retail business for solvency purposes (i.e., was it
10 appropriate to use book value or to make an upward adjustment
11 because the inventory was to be sold at retail?). In
12 dismissing the arguments that the Revenue Procedure provided
13 an answer, the court found the "Revenue Procedure, like
14 [GAAP,] to be unhelpful because the tax and accounting
15 implications of how assets are listed on a company's balance
16 sheet often have little to do with what a willing buyer and
17 willing seller would agree is the fair market value of those
18 assets." Id. at 357, n.3.

19 The parties in EBC I also disagreed regarding the
20 relevance of GAAP treatment of preferred stock. The court
21 found that GAAP was irrelevant to the question before it.

22 GAAP does not deal with the true market value of assets
23 or the determination of what are legal liabilities of a
24 company. . . Just as GAAP rules regarding the book value
25 of assets does (sic) not determine their fair market
value, similarly GAAP rules for treating debt as equity
and vice versa are not relevant in determining whether
they are truly debt or equity.

26 Id. at 358 (internal citations omitted).
27
28

1 The opinion of Roman Weil,²¹ nVidia's accounting expert,
2 is consistent with this position. In explaining why nVidia
3 used purchase accounting for the Transaction, he stated:

4 GAAP provide that if the acquirer purchases enough assets
5 so that it could readily, that is with minor effort and
6 cost, purchase additional assets to have a stand-alone
7 business, even if it has not, then the acquirer should
8 use purchase accounting for the assets it did purchase.
9 GAAP do not mean, by applying the purchase accounting
10 rule, that the asset purchase must have resulted in the
11 purchase of a business as that term is used in non-
12 technical language or that the transaction was an
13 acquisition of all the assets and liabilities of the
14 company. nVidia's accountants invoked purchase accounting
15 in order to explain why it used fair values, instead of
16 book values, and why it recorded goodwill for the
17 transaction.

18 Ex. N, p. 9.

19 For purposes of the issues to be decided here, this Court
20 believes that the positions taken in Kaypro, Sierra Steel,
21 Richmond Produce and EBC I in the context of solvency
22 determinations are applicable. GAAP or SEC rules will not be
23 used to exclude facts or the required analysis of those facts,
24 or to supplant the Court's fact finding role in this context.
25 GAAP will not determine what constitutes an asset or the fair
26 market value of an asset. The Court's determination of what
27 constitutes an asset will be guided by the applicable UFTA
28 definition, not the accounting definition.²² The evidence

29 ²¹ See Exhibit 1 to Ex. N for complete details regarding
30 Mr. Weil's qualifications as an expert on accounting issues.
31 In brief, he is a professor of accounting at the Graduate
32 School of Business of the University of Chicago.

33 ²² Statement of Financial Accounting Concepts No. 6
34 defines assets as probable future economic benefits obtained
35 or controlled by a particular entity as a result of past
36 transactions or events. Elements of Financial Statements,